

SPENDING AFFORDABILITY ADVISORY COMMITTEE REPORT



Fiscal Year 2019

**Spending Affordability
Advisory Committee**

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**Howard County Maryland
Spending Affordability
Advisory Committee
Report for Fiscal Year 2019**

March 2018

Purpose

County Executive Allan Kittleman renewed the Spending Affordability Advisory Committee (the “Committee”) through Executive Order in December 2017. The County’s Executive’s charge to the committee was to:

1. Review in detail the status and projections of revenues and expenditures for the County, not only for fiscal year 2019, but also for fiscal years 2020-2024.
2. Evaluate future County revenue levels and consider the impact of economic indicators such as changes in personal income, assessable base growth, and other data that the Committee considers applicable.
3. Evaluate expenditure levels with consideration of the long-term obligations facing the County, and the best way to pay for them.

The Committee shall present to the County Executive on or before March 1, 2018, a report including:

- a. Projections of revenue for the upcoming fiscal year;
- b. A recommended level of new County debt authorization;
- c. The anticipated effect of the Committee’s budget recommendation on future budgets;
- d. Other findings and/or recommendations that the Committee deems appropriate.

EXECUTIVE SUMMARY

The Spending Affordability Advisory Committee (“Committee”) noted that a strengthening national economy has not translated into local revenue growth. Furthermore, expenditure growth and projected needs of Howard County (“County”) continue to exceed projected revenues. As observed last year, revenue has not kept pace with the growing demands for County services and capital investment. In fiscal year (“FY”) 2018 the County experienced a \$7 million projected revenue shortfall which resulted in a mid-year 2% budget reduction for County agencies, exclusive of the education entities.

The Committee expects the County to experience continued slow revenue growth which will not keep pace with the increasing demand for services and capital investment. Changing demographics, anticipated reductions in federal and state expenditures, as well as possible decreases in the federal workforce will all affect the County’s long-term outlook. As the County’s population continues to age and change, there are significant challenges we must meet, including: support of our outstanding public education system; continued capital investments for roads, schools and other infrastructure such as upgrades and/or replacement to the County’s correctional facility; funding for safe communities; and paying our long-term obligations (pension, retiree health benefits, and debt service payments). At the same time, we are committed to sustaining the quality of life and advantages that distinguish the County.

Based on current fiscal projections, expected capital and operating expenditures will exceed projected revenues. Without changes to County revenues or expenditures, current patterns of spending are unsustainable in the long-term. We believe that a significant challenge for policy makers will be to balance the pending fiscal restraints against historical levels of service, so that the needs of the population are met. It is important for community and government leaders to understand the impact of, national, state, and local policies, which affect revenue sources, economic growth, personal spending decisions, and the County’s ability to fund future obligations.

SUMMARY OF RECOMMENDATIONS

Recommendations voted on by the Committee follow and further details are incorporated within Section II of the report.

- 1) Develop the FY 2019 budget based on a reduced projected revenue growth of 1.75% (\$19.05 million) over FY 2018 budget due to ongoing economic and other uncertainties.
- 2) Limit the amount of FY 2019 authorized General Obligation bond issuance to \$75 million.
- 3) Although the County’s preliminary multi-year revenues projections show 3.4-3.6% growth annually for FY 2020- FY 2024, the Committee recommends that the County take a more conservative approach, recognizing uncertainties.
- 4) Other Recommendations: Pages 7-11 show recommendations on Adequate Public Facilities Ordinance (“APFO”), revenues, expenditure control, multi-year planning, innovative approaches, and communication/engagement.

INTRODUCTION

The Committee is tasked with making recommendations to the County Executive on revenue projections, the debt ceiling, long-term fiscal outlook, and, as appropriate, other observations and recommendations on County revenue and spending patterns. The Committee met weekly from early January through February 2018. During that time, the Committee listened to and discussed presentations from economists, County agencies, and local educational institutions. These meetings helped the Committee develop a better understanding of the County's economic outlook, and related factors, including revenue sources, debt affordability, demographic trends, economic development, long-term planning, and operating and capital needs.

Before exploring the local economic landscape, it is important to understand federal and state conditions and policies and how these issues impact the County. In 2017, the U.S. recovery gained strength and near-term growth is expected to continue. Unemployment remains low, but employment growth is expected to slow down as the nation reaches "full employment". Wage growth, interest rates and inflation are expected to increase in 2018. Maryland, which has lagged behind the national averages during the economic recovery of the past several years, finally has experienced economic growth on par with the national level.

Significant uncertainties remain, not only in terms of economic and market risks (such as inflation and the stock markets) but also potential impacts from federal and state regulatory and spending decisions. For example, the state's initial analysis of the recent federal income tax law change showed that Maryland taxpayers could pay more state and local taxes as a result of this change. However, it is unknown whether, when, or to what extent state and local governments would realize such revenue gains. Actual revenues will depend on the impact of pending IRS interpretation, General Assembly decisions on state tax law, and consumer behaviors.

County revenues are significantly reliant on property and personal income taxes. Despite a continued recovery in the real estate market, the County's assessable property base, using the last state projections, will see a moderate growth rate of 2.4% in FY 2019 due to lower growth in residential property reassessment value and the state's three-year phase-in policy. In FY 2018, County year-to-date personal income tax collections dropped by \$12 million from a year ago primarily due to residents' planning in 2016 in anticipation of potential federal tax law changes.

In FY 2019, personal income tax revenue is projected to show modest recovery resulting from an improvement in wage growth but will be partially offset by a slowdown in anticipated employment growth in a move to full employment. In the long-term, demographic changes, such as an increasing number of retirees and the in-migration of families with lower income to the County could have a significant impact on both County revenues and service needs. Like the state, the County is highly reliant on federal employment and procurement and the uncertainty in future federal spending remains a concern, too.

Throughout the Committee's meetings and discussions, it became increasingly clear that in FY 2019 and subsequent fiscal years, the County faces significant challenges to funding both its capital improvement program (CIP) and operating budgets:

- General Fund revenues are expected to experience relatively weak growth in FY 2019 and maintain a moderate growth rate in coming years, which puts additional pressure on the County to meet various service needs and anticipated cost increases such as rising employee and retiree benefit costs;
- Revenue growth is not keeping pace with the significant CIP needs, including deferred maintenance and infrastructure needs;

- These challenges will remain and grow more severe in the next decade, as demographic trends (featuring an aging population and a continued growth in school-age population) and residential construction (showing a shift to multi-family housing drawing lower income residents and generating higher service demands, on average);
- Further, new and potential federal, state and local legislation (e.g., tax law, federal spending, local new housing development regulation [APFO], etc.) add to the County's economic growth and revenue uncertainties.

These challenges have significant implications on the County's service delivery capacities for its residents and businesses. Recognizing these issues, the Committee believes the County must consider a combination of the following options to meet the ongoing service needs:

- **Revenue growth options:** property and transfer tax increases and reallocation opportunity; ambulance fees; and continued promotion of commercial tax base development;
- **Expenditure discipline and prioritization:** balance the needs between education and all other services of the County; manage and address long-term liabilities such as debt service payments and retiree health benefits; tighten fund balance policies;
- **Process change and innovative approach to maintain and enhance services and results:** use of technology; school class size reconsideration to free up funding for school CIP and operating needs;
- **Commitment to long-term planning:** work in collaboration with education entities and develop long-term projections and plans, which connect operating and CIP budgets and reflect long-term differences between revenue growth and expenditure needs;
- **Collaboration and communications with other partners and the public:** work in collaboration with other government entities and key stakeholders to develop realistic budget and realistic long-term CIP plans; engage/educate the public and seek input on service prioritization and funding options.

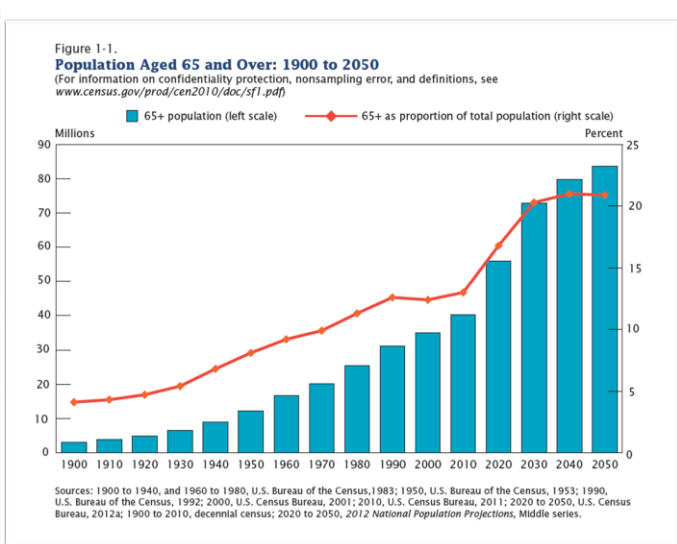
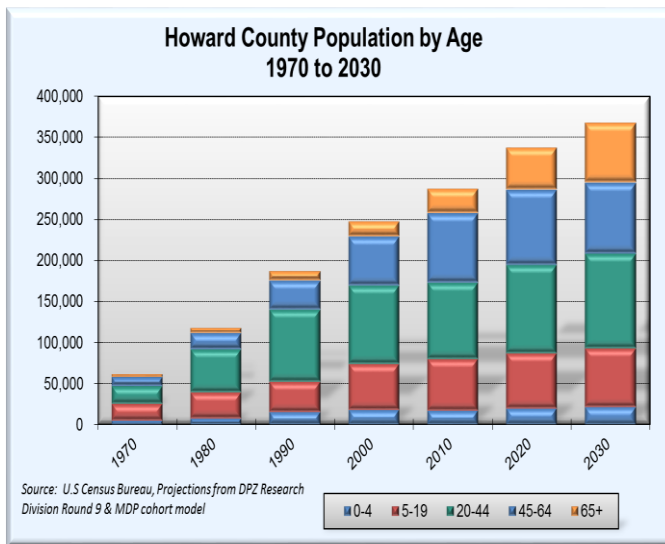
This report summarizes all major findings and recommendations and provides detailed background information on the economic and revenue outlook, debt indicators, and the County's multi-year projection.

I. DEMOGRAPHIC AND ECONOMIC TRENDS AND LONG-TERM SUSTAINABILITY

The Department of Planning and Zoning's presentation on key demographic and economic trends continues to emphasize the concerns that this Committee has had over the last few years. These trends will have significant impact on the County's near and long-term fiscal condition and should be a basis for the development of the operating and capital budget.

Examination of the County's demographics clearly indicates that our population is aging. While this is a national trend and not specific to Howard County, the County's population is aging much faster. Reports by the Maryland Department of Planning and the U.S. Census Bureau both project that the population over the age of 65 will nearly double by 2050, growing nationally from 43 million in 2012 to 84 million in 2050. The County's Department of Community Resources and Services conducted a similar study and projected that the population over the age of 65 will double within the County by 2025.

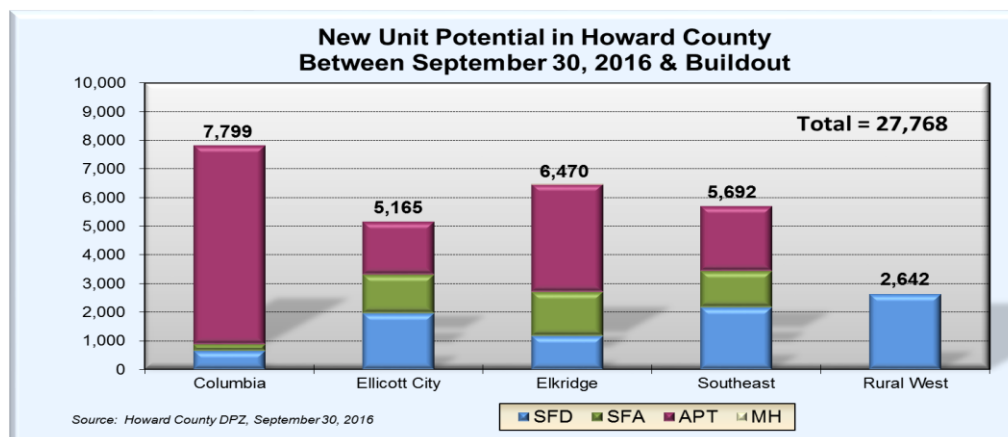
While the County encourages aging in place, an increase of residents over the age of 65 presents new fiscal challenges. As residents retire and age in place, retiree contributions to County revenues collected from the personal income tax decrease as retirees tend to generate less taxable income. Also, as this demographic continues to grow, the County needs to increase core services that specifically target and support this group of residents.



The aging population of the County is only one of our demographic challenges. Another is the increase in the number of school-aged children. Based on data provided by the Howard County Public School System (“HCPSS”), the growth rate in student enrollment from 2010 to 2019 (projected) averages 1.6% per year. This enrollment growth rate coupled with the current fiscal climate of the County, places the HCPSS under increased pressure to effectively meet student needs. Consequently the County’s budgets are pressured from both ends of the demographic spectrum: increasing operating and infrastructure needs for the HCPSS, and rising service demands for aging adults.

Moreover, the County’s overall population also has been growing at 1.6% on average in the past several years, demanding an increase in the full spectrum of County services ranging from public safety, public works, and health and human services to recreation and parks. How to address and balance these competing community needs with limited resources will remain a critical fiscal challenge for the County.

The next economic trend the Committee observed is the shift of planned development activity from single-family to multi-family housing. Two factors contributing to this shift are limited zoned acreage for single-family detached residential development and changing demographics in the continued influx of residents migrating to the County. Since 2010, residents moving into the County, on average have lower incomes than residents leaving the County, thus creating more demand for multi-family over single-family detached dwellings. With the increasing population and decreasing income levels, the County and the HCPSS are experiencing greater strain on financial resources to meet the needs.



(SFD – Single Family Detached; SFA – Single Family Attached; APT- Apartment; MH – Mobile Homes)

Finally, the Committee considered the County's resident employment growth. The County had experienced more growth than the rest of the state until recent years, when growth in employed County residents has slowed and lagged behind the state and national average during the economic recovery. Current data indicates that for the first time since 2014, employment growth has surpassed the national and state average. While new employment growth is projected to be slower in the foreseeable future partly due to full employment, wage growth is expected to improve. Personal income growth in the County is projected to show a moderate recovery of approximately 4% in the next few years.

II. SUMMARY OF RECOMMENDATIONS

1. Projections of Revenue for the Upcoming Fiscal Year

The Committee recommends development of the FY 2019 budget based on projected revenue of \$1.1 billion, an increase of 1.75% (\$19.05 million) over the approved FY 2018 budget (excluding use of fund balance).

The County is required by law to adopt a balanced budget. In FY 2018, the County is expecting to collect less than originally anticipated revenues, specifically revenues generated by the personal income tax. The Office of Budget presentation on the County's fiscal outlook laid out various reasons as to why revenues are lower than anticipated, specifically tax planning and uncertainty from the new federal tax plan. Due to the uncertainty around the federal tax plan as well as any pending action by the General Assembly, the Committee recommends basing the FY 2019 budget on a 1.75% increase over FY 2018 revenues. This is lower than the 2.2% most recently projected by the Office of Budget and less than half of the Committee's prior-year revenue growth recommendation. The Committee believes that the County and all its stakeholders must come to terms with the current fiscal climate and take actions to manage and control spending.

2. A Recommended Level of New County Debt Authorization

The Committee recommends limiting authorized new General Obligation bonds in FY 2019 to \$75 million.

As stated above, County revenues are already lower than anticipated and increasing uncertainty regarding the federal tax plan, federal budget, and state legislation that all have an enormous financial impact to the County, call for moderation. Due to these factors, the Committee is recommending that for FY 2019, the County authorize \$75 million for General Obligation ("GO") bonds. This new debt ceiling represents a significant decrease from the \$85-\$90 million recommended by the Committee in the past three years. The Committee, as it does with all recommendations in the report, took a vote after a long discussion on past, current, and future debt levels. Decreasing the debt authorization level, especially in this time of fiscal uncertainty, limits capital spending and keeps the overall debt burden at a reasonable level without impacting the capacity to support priorities identified in the operating budget. It also preserves the County's AAA bond rating and protects the ability to borrow at most favorable terms, allowing allocation of relatively more funding to other County needs.

3. The Anticipated Effect of The Committee's Budget Recommendations on Future Budgets

A preliminary multi-year revenue and expenditure model developed by the Budget Office suggests that County General Fund revenues will grow 3.4% ~3.6% in the out years through FY 2024. The Committee suggests that the County develop a multi-year fiscal plan that strategically balances service needs and resources to build a sound fiscal structure that supports the County's priorities. Although the County's

projections present a cautiously optimistic outlook in the future years, the Committee recommends that the County be more conservative and count on lower rates of revenue growth in the out years to reflect the uncertainty in the national, state, and local economic landscapes that are discussed in this report.

4. Other Recommendations that the Committee Deems Appropriate

Adequate Public Facilities Ordinance (APFO)

The recently passed APFO legislation has potentially wide-ranging impacts on the economic and fiscal health of the County. The current APFO legislation was passed without a comprehensive and detailed assessment (“study”) of its potential economic and fiscal implications, including: fiscal benefits and costs; impact on economic development; and impact on housing affordability. By curtailing development, the net effect of the legislation could limit the generation of County revenues required to meet the current and future operating expenditures, capital investments, and existing debt of the County. The study should also consider the impact changes mandated by the recently passed legislation would have on future student enrollment. According to County Department of Planning and Zoning, only 38% of student growth is attributable to new residential development; 62% is from resale of existing homes, which are not subject to APFO considerations.

The Committee recommends that the County conduct a comprehensive and detailed assessment of the economic and fiscal implications warranted by legislation. This non-partisan committee, representing the diverse communities and stakeholders impacted by APFO, is uniquely qualified to advise in the development of a request for proposal (“RFP”) of the impartial and comprehensive study required to inform the County of the impact and implications of this legislation. We, therefore, seek County authorization to take on an advisory role in this critical study as part of our ongoing mission to assess and advise on the fiscal and economic health of the County.

Revenue

Core services and capital needs will outpace the projected revenue growth, unless there are changes to the current revenue structure. Options for additional revenues include:

- **Transfer Tax:** The Committee once again had an in-depth discussion regarding the transfer tax and by consensus recommends that the County increase the current transfer tax from 1.0% to 1.25% on property transactions. The tax is imposed on all residential and commercial transactions and an increase in the tax will benefit the County’s CIP since it is primarily designated to fund capital projects. The recommended increase will generate approximately \$6.5 million in annual revenue that over the next 20 years can leverage approximately \$80 million in capital over 20 years if using bond financing or fund \$130 million of capital projects using cash funding.

The Committee also recommends the convening of a County taskforce every four years to review the current transfer tax structure, revenues and distribution, and recommend any changes to the formula going forward, as needed. The Committee recommends that this task force be comprised of representatives of all appropriate stakeholders including County and state officials, private citizens, and individuals from business groups and services providers that are directly impacted by the transfer tax formula. Currently, the transfer tax allocation formula set by the state is allocated as follows: 25% to school capital projects, 25% to parks construction, 25% to agricultural land preservation, 12.5% to housing, and 12.5% to fire and rescue services; any adjustment to the current transfer tax structure must be made at the state level by the General Assembly. The Committee strongly recommends that the County Executive in collaboration with the County Council, submit legislation to the state Delegation to assign the management of the tax to the County. The Committee believes that the County should have

local control of the rate and allocation of the transfer tax revenue. Furthermore, the Committee is concerned that the County has not acted upon a similar recommendation in past reports.

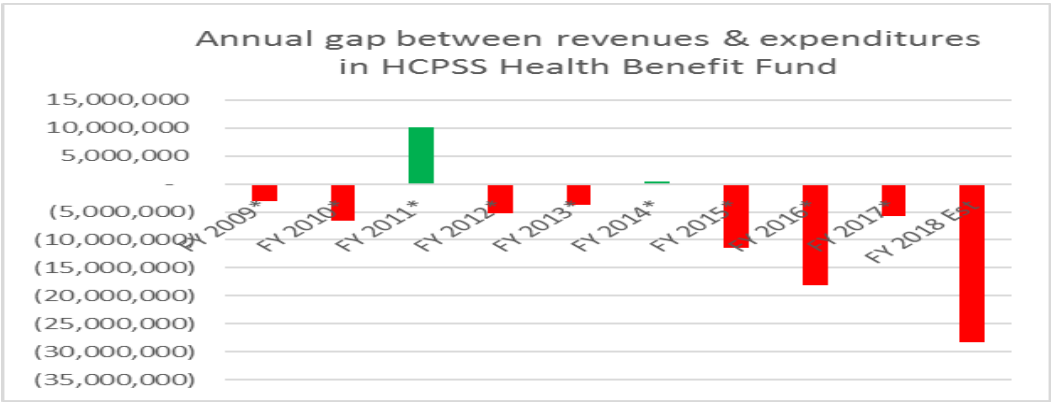
- **Ambulance/EMS Fee:** The Committee has consistently recommended that the County implement an ambulance/EMS transport fee. The fee would not be a tax on the use of emergency medical services, nor should it result in rationing of emergency medical care. Rather, it would primarily be paid by insurance companies and other providers as a reimbursement of costs incurred. Currently, Howard County is the only jurisdiction in Maryland that does not have such a fee in place. We are pleased to see that the County has moved forward in consideration of similar action by hiring a consultant to work on a fee study and directing an internal review by the Office of Budget and the Department of Fire and Rescue Services. Initial estimates suggest that the County can expect \$3-\$5 million in annual revenues once the fee is fully implemented. The Committee is encouraged to hear that the County has taken these preliminary steps and along with assurances that if and when it implements the fee, services to County residents will remain unchanged and a commitment to efficient and effective medical care will remain the Department's highest priority.
- **Recovery of Public Safety Overtime Costs:** While we appreciate the fact that the County Executive is taking steps to address permit fees, the Committee has expressed growing concern regarding the County's need to recover costs by the Police Department and Department of Fire and Rescue Services for overtime associated with special events. As the County looks to expand these cultural amenities, such events will increasingly strain available police, fire, and EMS services. The committee does not believe it is the intent of the admissions and amusement tax to offset overtime costs associated with events and recommends the collection of an event fee or direct charge to provide relief to the already strained General Fund, and to allow for more capacity to address County needs.

Expenditure Control

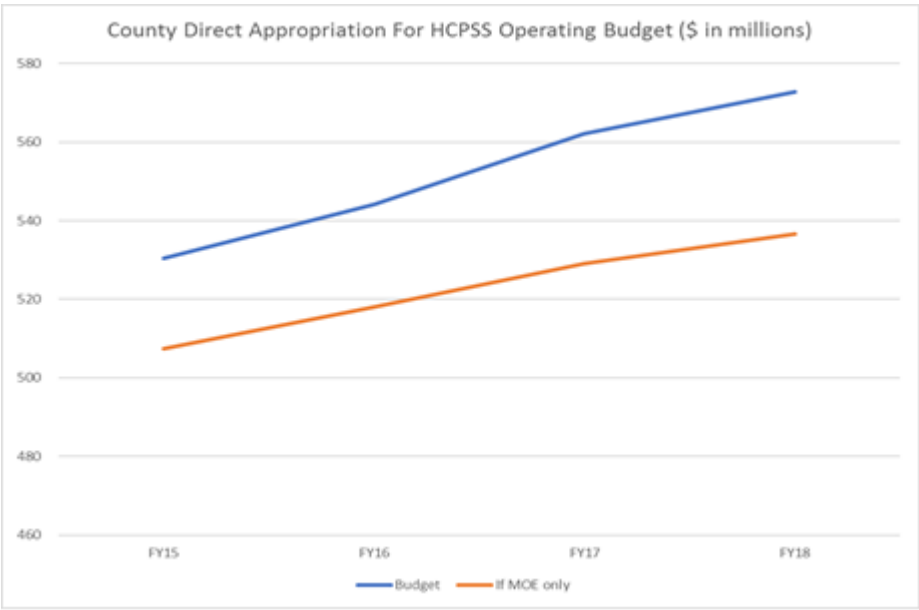
- **Howard County Public School System (HCPSS):** Education remains the County's top budget and policy priority. County funding to HCPSS is approximately 58% of the total General Fund, including debt service and retiree health benefits for HCPSS employees. Total County funding spent on education (including the Howard County Library System and Howard County Community College) is almost two-thirds of the County's General Fund, more than five times the funding allocated for public safety. County spending per pupil reached \$10,321 according to the latest available data, third highest in Maryland (after Worcester and Montgomery). The school superintendent's FY 2019 request for County funding is \$594.5 million, \$21.6 million (3.8%) higher than FY 2018. The amount includes \$10.2 million in state-mandated Maintenance of Effort ("MOE") and an additional \$11.4 million above MOE. The HCPSS-requested funding growth alone exceeds the County's entire projected General Fund revenue growth of \$19.1 million in FY 2019. Meeting the full request from HCPSS will require compromising other core services in the County. While the Committee applauds HCPSS' new administration for improved transparency in sharing financial information, the Committee would like to encourage the HCPSS to understand and accept the financial reality of limited resource availability and explore internal prioritization, process changes, and innovative approaches to living within the overall means of the County's fiscal restraints while still delivering quality services.

The Committee also recognizes that this budget request does not deal with the projected \$50 million cumulative deficit for FY 2018 that HCPSS has created in its own health benefit fund. The issue is attributable to the HCPSS consistently underfunding its health fund (in eight out of past 10 years) as shown in the graph below, and repeatedly using its fund balance as one-time resources to support on-going needs. Such practices have gradually resulted in a significant and growing structural imbalance in

that fund. The Committee urges HCPSS to take ownership of the issue and develop a feasible multi-year plan with permanent solutions to address the matter before coming to County government or County taxpayers for assistance.



- Maintenance of Effort (MOE) Contribution to HCPSS:** In FY 2019, HCPSS’ MOE increase is \$10.2 million. As indicated in last year’s Committee report, while the County has been able to fund in excess of the MOE amount in certain years, it has no requirement to fund over that amount. In fact, each year that the County increases the MOE beyond the required contribution, it increases the baseline for subsequent years. Given the uncertainty of the County’s fiscal situation, already limited revenue growth from FY 2018, and its modest revenue forecast moving forward, funding HCPSS beyond MOE will reduce the ability to allocate funding to address other County needs. As the County population continues to increase and demographics continue to change, a growing need for non-education priorities in the County also must be addressed. The chart below demonstrates what the County annually provided to HCPSS versus what would have been appropriated based on MOE only in the past four years. The Committee’s recommendation in regards with MOE is aligned with the recommendations made above in the HCPSS section.



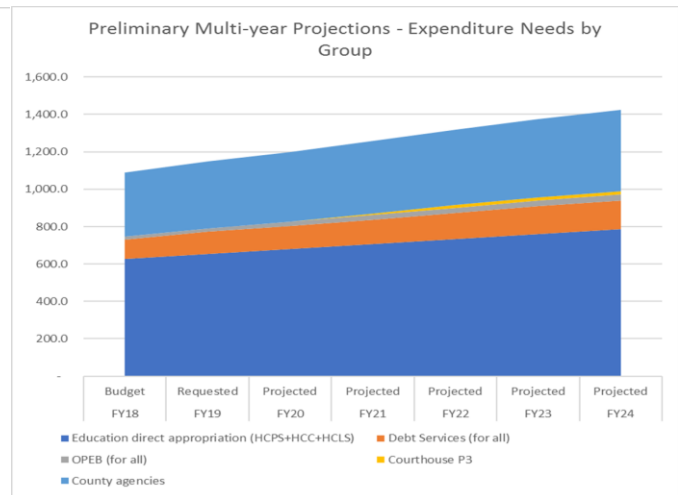
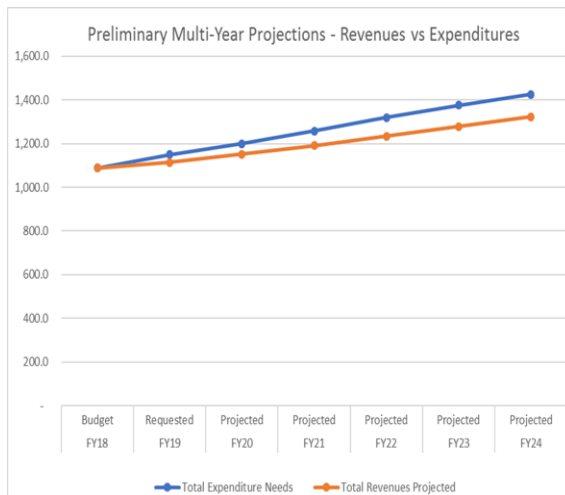
- Other Post Employment Benefit (OPEB) Contribution beyond PAYGO:** The Committee applauds the County for continuing its multi-year phase-in plan towards fully funding OPEB liabilities and

resisting the temptation to reallocate funding towards other operating needs. Steering away from the incremental funding plan could significantly impact the current discount bond rate and increase the overall cost of covering the OPEB liabilities. Also, it would negatively impact the teachers of the HCPSS because 66% of OPEB funding is obligated for retiree health benefits of Howard County teachers.

- **Use of Fund Balance:** The Committee recommends that the County Executive continue to exercise restrictive policies on use of prior year fund balance. The Committee recommends once again that the County not use more than 50% of the prior year unassigned fund balance in the upcoming fiscal year. As presented by the Department of Finance, maintaining a healthy fund balance that allows the County to weather fiscal, economic, and emergency situations is critical to maintaining the County's AAA rating. Per advice of its financial advisor, the County is developing policies to increase the available portion of the fund balance to provide for increased budget flexibility. The Committee agrees that the County should grow and protect its fund balance against risks especially in a time of uncertainty.

Multi-Year Planning

- **General Obligation Bond Study:** Two years ago, the Committee charged the County to correct the historical practice of overestimating capital funding in CIP plans and use a more practical and methodical approach to planning capital projects. The Committee also charged the County to conduct a thorough review of existing authorized GO bonds in order to determine whether some could be closed to free debt capacity. The Committee is pleased to see that the County embraced both of the Committee's recommendation and implemented them in the current budget process. Long-term CIP planning funding and expenditures have been dramatically reduced and portray a realistic long-term plan. Authorized but unissued bonds have also decreased from \$381 million to \$255 million in FY 2018. The Committee recommends that the County continue this fiscal discipline in order to decrease the amount of authorized but not issued bonds.
- **Revenue/Expenditure Multi-Year Projections:** Following the Committee's recommendations last year, the County developed a multi-year projection of both revenues and expenditures incorporating input from all stakeholders of County revenues such as County agencies, the Howard County Public School System, the Howard County Community College, and the Howard County Library System. The models as shown below indicate a potential gap of \$40 million between projected revenues and expenditure requests in FY 2019, which could grow into an annual gap of \$100 million by FY 2024 if no corrective actions are in place. In addition, uncertainties in future federal, state, and local economic conditions and other economic events, will constrain the revenue growth projections, causing the gap to be more pronounced. The projections reveal fundamental challenges to balancing limited resources (growth) and rising needs of the County. The Committee recommends that the County work in collaboration with all key stakeholders to develop long-term strategies to address and close those potential gaps in the future, as well as provide for contingencies if revenue growth is less than projected.



Other / Innovative Approaches

- Partnership / Commercial Base Development:** The Committee recommends that the County, in cooperation with the Economic Development Authority, continue to aggressively pursue new businesses to open or relocate to the County, especially around technology. As further discussed below, while the County's commercial base continues to grow above the state average. The County should continue to seek opportunities to leverage resources to attract and retain businesses, and increase support for entrepreneurship, innovation, and small business programs to diversify the employment base. Given the lead-time for development and the limited opportunity for growth in the County's tax base, the Committee recommends expediting the redevelopment of Gateway and approval of an associated masterplan.
- Investment for Efficiency & Productivity:** Last year the Committee recommended that the County pursue the integration of the SAP business suite technology across County operations as well as other technological improvements. The Committee has been informed by the Office of Budget that the County is currently engaged in efforts to enhance its current SAP module to better enhance productivity throughout the County. It is also investing in workforce management software in order to automate payroll operations. Finally, the Department of Technology and Communication Services is looking to improve current labor-intensive processes such as procurement with technology, which will allow for better workflow and management. The committee affirms these improvements and recommends continued efforts to streamline and effect county efficiency.

Communications and Engagement

- Collaboration, Communications and Engagement:** It is important that the County engage and educate the public about the challenges the County faces, and seek their input regarding potential options, and solutions. The Committee additionally recommends that the County strengthen its partnership with all key stakeholders including education entities in discussing the long-term challenges and collaborate develop strategic plans jointly.

We would like to thank all the Committee members for their time and effort providing insight and thoughtful ideas that will help continue to move this County forward. We also want to thank all of the presenters who shared valuable information and analysis with the Committee.

III. DETAILS / BACKGROUND

1. Economic Outlook

The Howard County Budget Office retained Richard Clinch, PhD, Director of the Jacob France Institute at University of Baltimore to prepare a County personal income projection through Fiscal Year 2021 and a report on overall national, state and regional economic trends and their expected impact on the County's economy and government finances. This report was prepared to provide personal income and economic data to inform the County's Spending Affordability Committee and process. The key findings of this analysis are as follows:

National Economy

- The national economic recovery strengthened in 2017, real gross domestic product increased 2.3 percent in 2017, up from 1.5 percent in 2016, and the national unemployment rate fell to 4.4 percent in 2017, down from 4.9 percent in 2016. With the nation at full employment, wage growth can be expected to accelerate in 2018.
- According to Moody's Economy.com, U.S. real GDP is projected to grow by 2.2 percent in 2017, by 2.9 percent in 2018 and 2.1 percent in 2019, with the Maryland Board of Revenue Estimates ("BRE") projecting growth in U.S. real GDP of 2.3 percent in 2017, 2.6 percent in 2018, and 2.3 percent in 2019.
- According to Moody's Economy.com, U.S. employment is projected to grow by 1.5 percent in 2017, by 1.5 percent in 2018 and by 1.0 percent in 2019, with the BRE projecting non-agricultural employment growth of 1.5 percent, 1.5 percent and 1.3 percent respectively.

State Economy

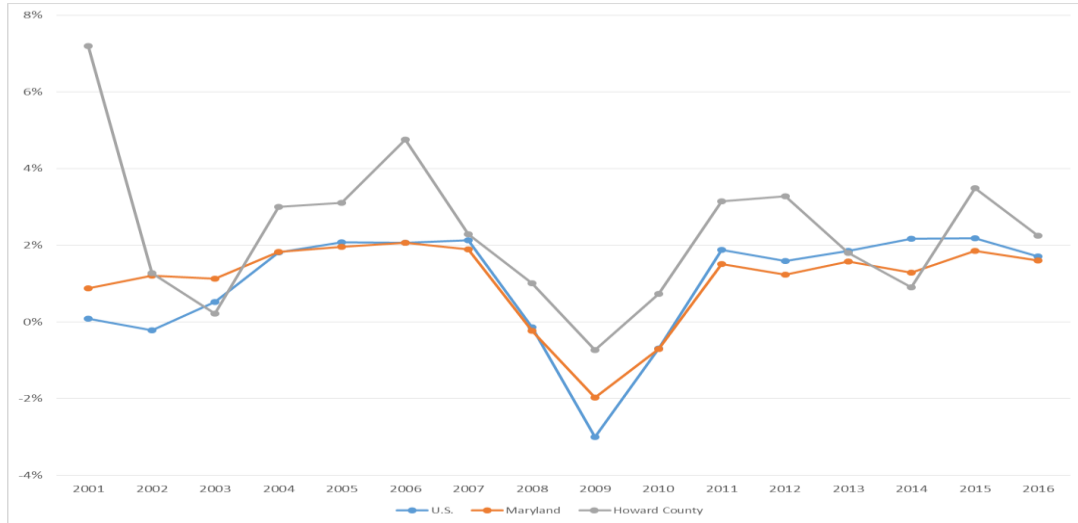
- The BRE forecasts state employment growth of 1.3 percent in 2017, 0.8 percent in 2018, and 0.5 percent in 2019. The Board of Revenue Estimates forecast is for Maryland personal income to increase by 3.6 percent in 2017, 3.7 percent in 2018, and 3.8 percent in 2019.
- Moody's Economy.com predicts stronger growth in Maryland and forecasts that employment will increase by 1.7 percent in 2017, by 1.3 percent in 2018 and by 0.9 percent in 2019 with personal income growth of 3.8 percent, 4.5 percent, and 4.8 percent respectively.
- Both Moody's and the BRE expect national and state employment growth to slow over the next few years with the nation at full employment and, for Maryland slower federal spending growth, however; wage growth and resulting personal income growth can be expected to accelerate.

Howard County Economy

- Howard County is well positioned for economic and income growth in 2018. The County population is growing, employment is expanding, and the County real estate market has recovered and is growing. However, there are reasons for continued caution in forecasting County spending affordability conditions. The County has lagged the nation and state in personal income growth for much of the recovery and the County's base of employed residents has lagged the state for the past two years. More importantly, given the considerable uncertainty over the trajectory of federal spending in the coming year and the County's reliance on federal employment and procurement, near term income growth and economic activity could be negatively impacted by changes in federal spending.

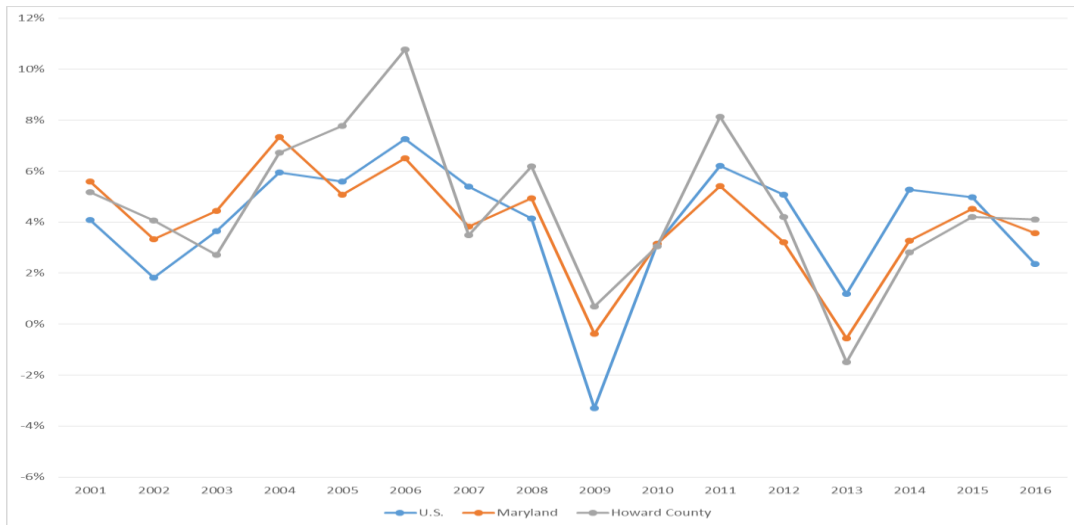
- County personal income is projected to grow by 3.9 percent in FY 2017, 3.9 percent in FY 2018, 4.1 percent in FY 2019, 4.0 percent in FY 2020 and by 3.7 percent in FY2021. On an annual basis, County personal income is projected to grow by 3.8 percent in 2017, 4.1 percent in 2018, 4.2 percent in 2019, 3.8 percent in 2020 and by 3.5 percent in 2021.

Chart: Total Employment Growth – U.S., Maryland, and Howard County



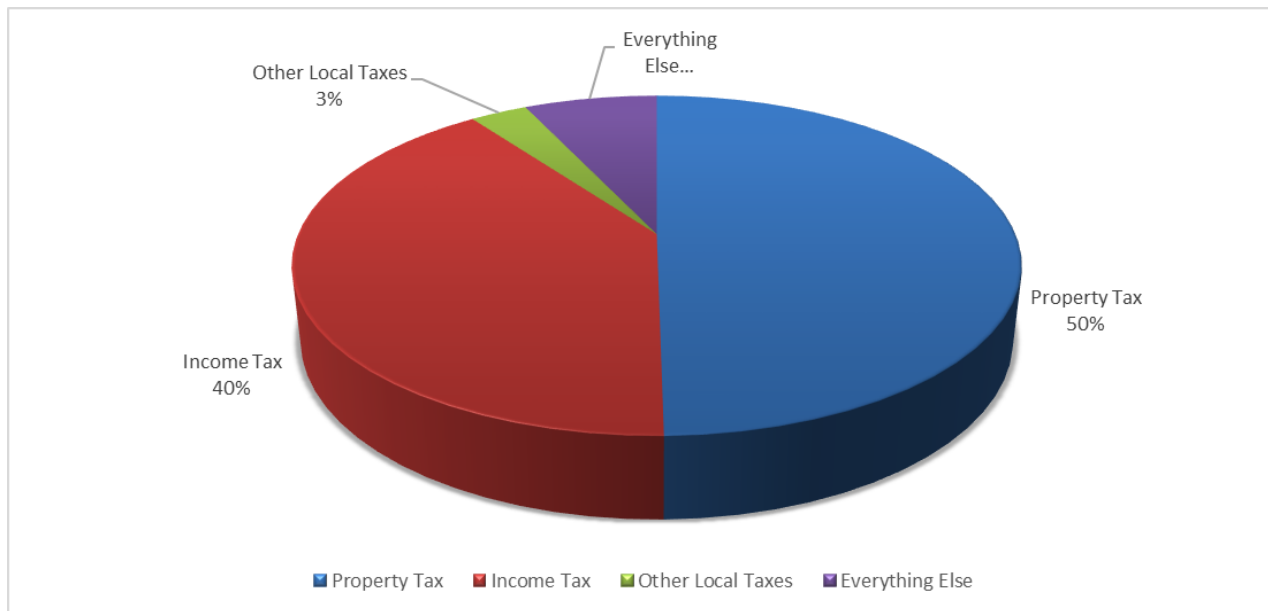
- Maryland and Howard County unemployment rates have been below the national average nearly continuously since 2001; however, in the recovery from the Great Recession, the gap narrowed and Maryland's November 2017 unemployment rate was actually higher than the national average.
- Howard County's unemployment rate at 3.1 percent remains well below the national (3.9 percent) and Maryland (4 percent) rates.
- Maryland lost fewer jobs than the nation in the Great Recession, but its employment growth has consistently lagged the nation throughout the recovery, and after lagging the nation in 2013 and 2014, employment growth rates in Howard County returned to levels above national and state level in both 2015 and 2016. However, while unemployment remains below both state and national averages and recent employment growth has returned to rates above the national average, personal income growth in Howard County lagged the nation for most of the recent recovery.

Chart: Personal Income Growth – U.S., Maryland, and Howard County



2. Revenue Outlook

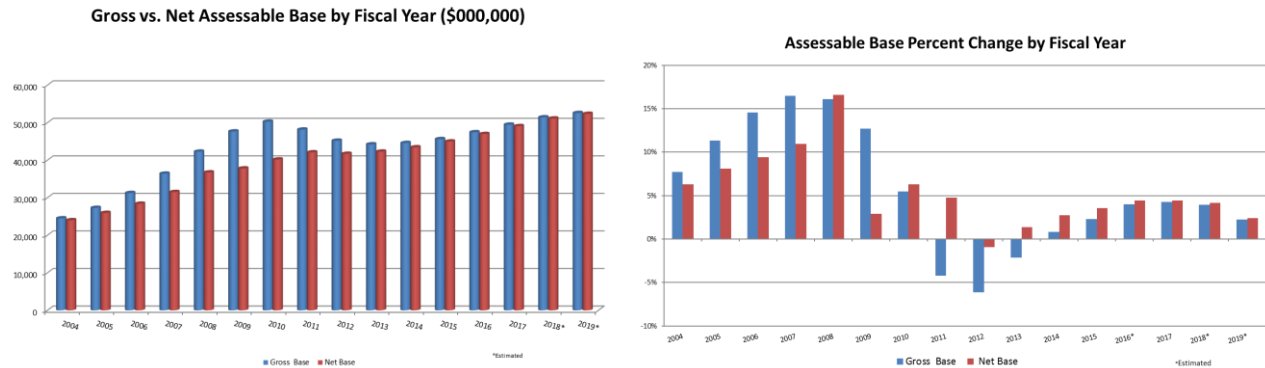
Howard County's General Fund revenues rely primarily on two sources, property tax (50%) and personal income tax (40%). These two revenue sources have made up approximately 90% of overall revenues over the last few years and the trend will continue going into FY 2019. The County forecast for General Fund growth in FY 2019 over FY 2018 budget is 2.2%. However, the Committee reduced the forecasted growth to 1.75% due to various uncertainties including risks in assumed personal income tax gains as stated below. (Everything else... pie chart)



Property Tax reassessment has continued to slow down and lagged the state average for a third straight year. The State Department of Assessments and Taxation reassessed Group 3 at 5.9% (State 7.7%) at full value, or less than 2.0% on average in the next three years. The residential reassessment continues the same overall trend and was reassessed at only 2.7%. In comparison, the commercial base reassessment continues to see double-digit growth, a trend that started with the reassessment in 2013. The commercial reassessment for 2018 is 15.5% and continues to be a significant driver of the overall annual assessment growth for the

County. The net assessable base for FY 2019 is projected to grow at 2.4% over FY 2018, continuing the County's slow property tax growth post-recession.

The County's net real property tax growth continues to benefit from diminishing credits from assessments subject to the Homestead Tax Credit. As the County continues to expand, new construction will continue to contribute to the growth in total property taxes each year.



Personal Income Taxes are expected to recover in FY 2019 after revenue through this point of FY 2018 is lower than anticipated. Due to uncertainty regarding the passing of the new federal tax plan and tax delays in tax planning, County personal income tax revenue is estimated to be \$12 million less than the budgeted amount in FY 2018. It should be noted that this is a statewide problem. The County is anticipating that the new federal tax law will have a positive impact on personal income tax revenue. However, the General Assembly is currently working on legislation to limit the impact of an increased tax burden to Maryland taxpayers, which could remove some or all potential state and local revenue gains generated by the new federal tax plan. The Committee believes that, due to this uncertainty, the County should exercise caution when forecasting personal income tax revenue in FY 2019 and apply a more conservative approach, instead of assuming its usual growth rate. As a result, the Committee reduced the County Budget Office's total revenue projections by \$5 million; thereby lowering projected General Fund revenue growth from 2.2% to 1.75% to hedge against such risks and uncertainties.

In its growth projection, the County has taken into account the negative impact of the Wynne case. According to the latest information provided the State Comptroller's Office, the County is looking at historical liabilities of approximately \$9 million based on processed and approved cases. In addition, the County is estimating annual revenue losses of approximately \$1.5- \$2.0 million from tax payers filing tax return applications based on the Wynne case results. Currently, all counties will begin installment payments for historical liabilities starting in May of 2019 (end of FY 2020). However, pending legislation in the General Assembly may delay the start of repayment to May 2021.

Other revenues are projected to either stay relatively flat or experience minor growth. Overall, taxes such as Recordation, Hotel/Motel, Transfer Tax, et al., will grow at approximately 2%. The Governor's FY 2019 proposed budget increased direct State Aid to the County by 4.0% over FY 2018. Furthermore, the Governor's budget increased direct aid to education entities by 4.6%.

3. Debt Indicators

In order to determine Howard County's relative debt position, the Committee in past years has evaluated the County's debt based on measures used and published by Moody's Investor Service and International

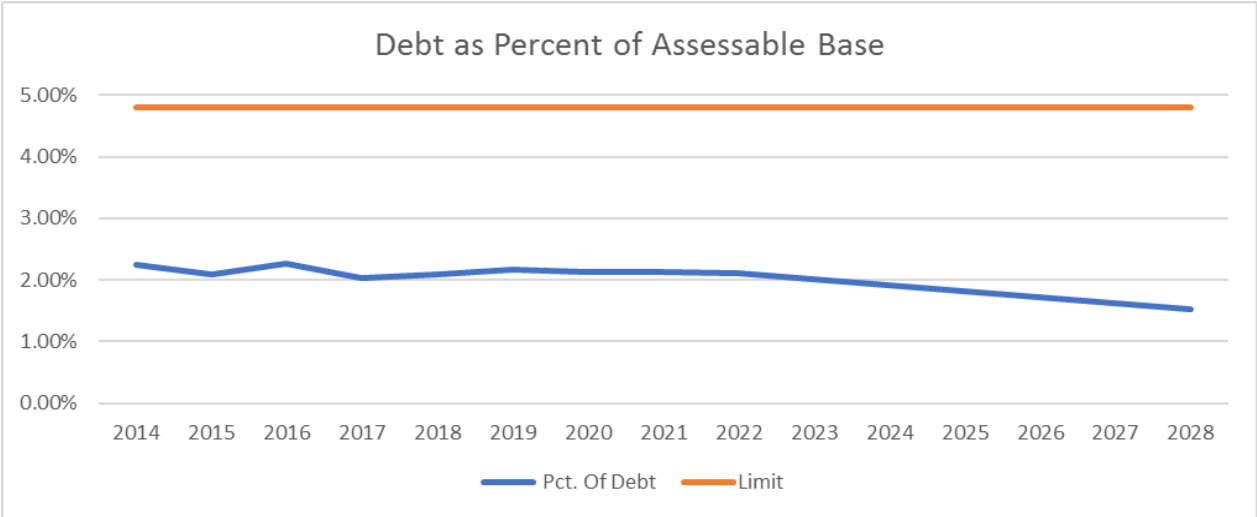
City/County Management Association publications. Four measures have been used to evaluate the County’s debt burden and debt affordability:

- Debt measured as a percent of the County's assessable base. The current County charter limit is set at 4.8 percent of assessed value.
- Debt measured against the population on a per capita basis. Per capita debt exceeding \$1,200 (unadjusted for inflation over the past 10 years) may be considered excessive by rating agencies.
- Per capita debt measured as a percent of the jurisdiction's per capita personal income. This measure should not exceed 10 percent in the view of many analysts.
- Debt Service as a percent of current revenues. This is the most important debt indicator among the four listed. Ten percent or below is considered an appropriate level, with 15 percent and above regarded a danger point.

The latest values of these four debt indicators are listed below. (Note: The previous year’s measures are shown in brackets []).

Measure #1: Debt as a Percent of the Assessable Base

As of June 30, 2017, [2016], Howard County had an assessable base of **\$49,616,808,995** [\$46,641,613,341] and a General Obligation (GO) Debt of **\$1,012,915,000** [\$1,075,162,952]. This means that the ratio of debt to base was **2.04%** [2.26%] of assessed value versus the 4.8% limit. Preliminary projections indicate that this measure will remain relatively low in coming years.



Measure #2: Debt measured against the population on a per-capita basis.

As of June 30, 2017, [2016], Howard County had a population of 318,115 [313,414] and a General Obligation Debt of **\$1,012,915,000** [\$1,075,162,952] generating a per-capita debt of **\$3,184** [\$3,061].

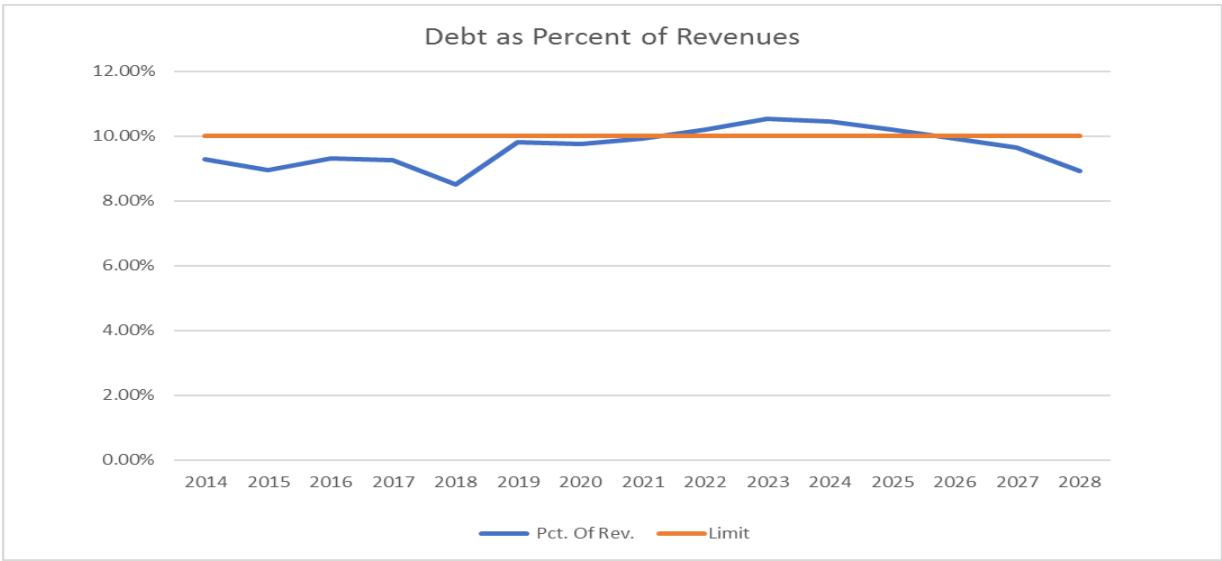
Measure #3: Per-capita debt measured as a percent of per-capita income

For 2017 [2016], Howard County residents had an estimated per-capita personal income of **\$72,826** [\$71,190] and a per-capita debt of **\$3,184** [\$3,061] equaling a per-capita debt of **4.37%** [4.30%] of per-capita income.

Measure #4: Debt Service as a percent of current revenues.

In FY 2017 [2016], the County received **\$1,161,948,168** [\$1,137,027,535] in revenues from the General Fund, Fire and Rescue Fund, and Environmental Service Fund and paid debt service of **\$107,464,406** [\$105,941,303]. Thus, debt service equaled **9.25%** [9.32%] of current revenues. This debt indicator is the most important measure of the four, indicating not only debt affordability but also the ability of the General Fund to support other strategic priorities (after dedicating resources to debt obligations).

This indicator is projected to grow continuously partly driven by existing authorized but not issued GO bonds and increased current and future capital needs from HCPSS and the County. Adding the new courthouse project will cause the County to slightly exceed the 10% policy target in FY 2022 – FY 2025 to 10.2% - 10.5%. After that, this indicator is expected to trend down and fall below 10%. It is worth noticing that 10% is a self-imposed policy ceiling and exceeding it temporarily is not predicted to cause any immediate changes in County credit ratings. Nevertheless, the Committee is aware of the tight debt capacity based on current revenue streams and CIP needs.



4. Multi-Year Projections

The County’s budget office developed multi-year projections based on historical trends and anticipated drivers of revenue growth and expenditures. Preliminary projections show that General Fund revenue growth will continue a moderate growth of approximately 3.4-3.6% per year during the FY 2020~FY 2024 period. This level of growth is still regarded as solid growth and should be considered the “new norm” moving forward.

The Committee continues to be concerned that this level of revenue growth may not meet the expenditure demands in current and future years. Major cost drivers include increased needs in education, growth in compensation and fringe benefits for employees, debt service, and increasing needs of the community. It is imperative that the County continues to work with key stakeholders to find ways to live within its means

while supporting critical services. It is time for the County, as a whole, to review core processes and services and find efficiencies in order to reduce costs instead of simply raising more revenues to meet service needs. At the same time, find ways to use the County's excellent resources to continue to attract high quality businesses, employees, and residents.

As in all models, the multi-year projection scenarios listed are based on a set of assumptions that could change when new information becomes available or the impact of changes in policy are considered. Nevertheless, this modelling provides a tool useful in identifying the affordable level of growth and understanding the implications of different scenarios.

Howard County Revenue/Expenditure Growth Projection Model

The County's Budget Office develops multi-year projections for its General Fund. The following model shows updated FY 2017 actuals and FY 2019 revenue projections as of February 2018. The model also includes preliminary projections for FY 2020 – FY 2024. In terms of expenditures, the County is required to pass a balanced budget annually with the expenditures staying within projected revenues. It is important to note that while these projections are based on logical assumptions today, the County still faces uncertainty in regard to revenues generated from the personal income tax, federal employment and spending, and other economic factors that the County is reliant on.

Details of the multi-year revenue projections and one of the many possible expenditure scenarios that match the projected revenue growth are shown below.

	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
	Projected	Projected	Projected	Projected	Projected	Projected
Property Taxes	548,616	565,074	582,027	601,234	621,074	641,570
Income Tax	450,677	468,704	487,452	506,950	527,228	548,317
Other Local Taxes	33,403	34,405	35,437	36,500	37,595	38,723
State Shared Taxes	1,628	1,661	1,710	1,762	1,815	1,869
Charges for Svcs./Other	35,362	36,281	37,225	38,193	39,186	40,204
Investment/Transfers	43,196	44,492	45,827	47,201	48,617	50,076
Prior year Funds						
			-			
Total Revenues	1,112,882	1,150,618	1,189,678	1,231,840	1,275,516	1,320,760
Education	639,689	658,205	672,685	689,089	710,771	733,638
Public Safety	137,509	141,291	143,915	147,226	151,937	156,799
Public Facilities	70,865	72,814	81,770	91,151	94,068	97,078
Community Services	69,648	71,563	73,209	74,893	77,290	79,763
General Government	29,004	29,802	30,487	31,188	32,186	33,216
Legislative & Judicial	28,228	29,004	29,671	30,354	31,325	32,328
Debt Service	109,254	116,254	123,254	130,254	137,254	144,254
PAYGO/OPEB/Other	28,685	31,685	34,685	37,685	40,685	43,685
Total Expenditures	1,112,882	1,150,618	1,189,678	1,231,840	1,275,516	1,320,760
Surplus/(Deficit)	0	0	0	0	0	0

General Fund Multi-Year Projections (\$000)

Note: expenditure projections are shown for illustration purpose and do not represent long-term fiscal plans.